NOV 4 1991

Regional Commissioner
Midwest Region

Deputy Assistant Chief Counsel, CC:IT&A

BEE-12 Forms Simplification, Form 1120 and 1120-A Recommendations

This is in response to your memorandum to the Chief Counsel, dated June 27, 1991, in which you requested comments on the proposed Form 1120 and 1120-A recommendations. Specifically, you asked that we consider the following: (1) review the 25 suggestions on modifying Form 1120, (2) comment on the suggestion to eliminate Form 1120-A, (3) review the suggestions to modify Form 1120-A, and (4) comment on the financial statement approach to Form 1120.

In order to do so it was necessary for us to coordinate with several Branches within the Office of Chief Counsel. We consulted CC:CORP:02 for a specific answer on the problems involved in modifying section 1.1502-76(j) of the Income Tax Regulations. Their memo is attached. CC:IT&A:09, one of our methods and periods branches, forwarded the attached response, which strongly endorses the elimination of Form 1120-A and makes other useful suggestions. CC:IT&A:06, in its memorandum, addressed the "adequate financial statement" question, discussed supplemental vs. primary use of the financial statement, and commented on two of the 25 suggested changes to Form 1120.

In summary, other than the two concerns mentioned in the CC:IT&A:06 memo, we are in agreement with the suggested changes to modify Form 1120. We concur with the recommendation to eliminate Form 1120-A. However, if the form is not eliminated, we are in agreement with the suggested changes to Form 1120-A. We have enclosed our comments on the financial statement approach which will obviously have to be looked at in greater depth by the Service before adoption or initiation of any regulation project.

cc: Director, TF:P

Irwin A. Leib

08693

Internal Revenue Service
memorandum

date: September 16, 1991

to: Chief, CC:IT&A:5

from: Chief, CC:IT&A:9 D. Seeman / pch

subject: BEE-12 Forms Simplification - Form 1120 Phase XII

The following comments are provided in response to your technical assistance request.

SUGGESTIONS TO ELIMINATE FORM 1120-A

I would recommend Form 1120-A being eliminated. This not only helps the taxpayers by eliminating some confusion but also helps the Service because information from taxpayers will be presented in a uniform manner and assist in processing and auditing.

SUGGESTIONS FOR EXISTING FROM 1120, PAGES 2-2 THRU 2-13

Item 16. Sch L.

Quite often the balance sheet is prepared on an accounting method different from the accounting method on which the tax return is prepared. An additional questions needs to be inserted either immediately after the heading for Sch. L or as part of the general information asking the taxpayers what accounting method the balance sheet and the tax return is prepared. (see below)

Item 19. Combine under "other current liabilities"

Has "other current liabilities" been defined anywhere in the form for the taxpayer?

FINANCIAL STATEMENT APPROACH. PAGES 5-1 THRU 5-12

This is definitely a more realistic approach. The Service should benefit greatly by this approach in time saved during audits.

Often taxpayers maintain books and records on one method of accounting for financial statement purposes and maintain another set of books and records on another accounting method for tax purposes. The new approach to the Form 1120 is for the taxpayer to begin with the corporation's financial statement income. Therefore Item G needs to be modified to obtain the method of accounting used for both finaicial statements and tax returns purposes. It is suggested that Item G be modified as follows:

Check method of acxcounting used for:

Financial statements Purposes		Tax Return Purposes	
(1)	Cash	(1)	Cash
(2)	Accrual	(2)	Accrual
(3)	Other (specify)_____	(3)	Other (specify)___

Taxpayers may have items treated differently on financial statements prepared for SEC, lending institutions or GAAP. One question that needs additional study would be as follows:

If the taxpayer has financial statements prepared differently for different purposes, the taxpayer should attache a copy of each financial statement and provide explanations for the treatment of different items.

cc: Joe Vukovich

Internal Revenue Service
memorandum

date: SEP 13 1991

to: Chief, CC:IT&A:05

from: Chief, CC:CORP:02
Edward A. Asher

subject: BEE 12 Forms Simplification Form 1120 Phase XII
Issues involving section 1.1502-75(j) and related items.

This is in response to your Technical Assistance Request of August 15, 1991. We understand that the purpose of BEE 12 was to make suggestions for changes to Form 1120 and Form 1120A. As finalized and forwarded for review, the report suggests that Forms 1120 and 1120A should be eliminated and replaced with a Financial Statement Approach. Because the Financial Statement Approach follows a taxpayers normal method for preparing its own financial statements, it represents a novel means of securing needed information with the least burden on taxpayers.

Specifically, you request our comments on the suggestion that section 1.1502-75(j) of the Income Tax Regulations would have to be modified with regard to filing a consolidated tax return.

Section 1.1502-75(j) of the regulations concerns statements and schedules for subsidiaries.[1] It provides that the statement of gross income and deductions and the schedules required by the instructions on the return shall be prepared and filed in columnar form so that the details of the items of gross income, deductions, and credits for each member may be readily audited. Such statements and schedules shall include in columnar form a reconciliation of surplus for each corporation, and a reconciliation of consolidated surplus. Consolidated balance sheets as of the beginning and close of the taxable year of the group, taken from the books of the members, shall accompany the consolidated return and shall be prepared in a form similar to that required for reconciliation of surplus.

The proposed changes would not only revise the method of preparation of the required information but would add a further requirement. Using the financial statement approach to filing a tax return, "consolidated financial statement" information could include entities that are not part of the consolidated return.

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[1] Prop. Reg. Section 1.1502-75(j), finalized T.D. 7246 (1/4/73).

Thus, the report suggests that section 1.1502-75(j) of the regulations should be modified extensively. Modifications that not only change the method of reporting subsidiaries income and deductions but also require further information be submitted by the taxpayer than presently required by the regulations. Information that is, in fact, not part of a determination of consolidated taxable income. We would not object to a requirement that <u>both</u> forms of reporting be required, that is, financial statements of subsidiaries and other entities and the information currently required by section 1.1502-75(j).

We have carefully examined the proposals for modification of section 1.1502-75(j) of the regulations and have no major objections to them. You should be aware that we will need lead time prior to the publication of these changes because modification of the regulations is a time consuming project. This type of change requires Treasury approval. While we don't anticipate any current policy issues with regard to this modification, policy issues can change or arise at any time.

Internal Revenue Service
memorandum

date: SEP 11 1991

to: Chief, CC:IT&A:05

from: Chief, CC:IT&A:06

subject: BEE-12 Forms Simplification- Form 1120 Phase XII

This is in response to your memorandum of August 15, 1991, in which you requested technical assistance concerning the review of the Simplification Phase Group Study Reports' BEE-12 Forms, particularly the proposal concerning defining an "adequate financial statement" in a manner modelled after former section 56(f)(3) of the Internal Revenue Code.

We have the following comments in regard to the following items on pages 2-2 through 2-13:

#5. "omitting cents."

Section 6102(a) of the Internal Revenue Code provides the Service with the authority to permit that taxpayers may "omit" cents in completing the tax return and instructions. However, because section 6102(b) of the Code provides that taxpayers may nonetheless elect not to use whole dollar amounts, we question whether the Service has the authority to require taxpayers to omit cents.

#8. election to forego the NOL carryback.

The amount reported on line 27 (line 28 on the current form 1120) may not be the taxpayer's net operating loss (NOL). This amount may need to be adjusted for other amounts, such as the dividends-received deduction. Therefore, although we believe the concept of having the taxpayer check a box to make the election to forego the carryback is a good suggestion, we do not believe that the form should provide that "if line 27 is an NOL, and you elect to forego carryback to the three preceding years, check here []."

We express no comments concerning pages 3-1 through 3-8.

We have the following comments in regard to pages 5-1 through 5-12:

Financial Statement Approach

GENERAL COMMENTS

authority

We question whether the Service has the authority (for example, under the Paperwork Reduction Act of 1980) to require taxpayers to attach their financial statements filed with the SEC (or a lending institution, or etc.) with their tax returns in addition to providing the additional M-1 information now required under the proposal.

taxpayer opposition

Assuming the Service does have the authority to request the taxpayer to provide this additional information, taxpayers may protest the filing of their financial statements and accompanying footnotes and reports with the IRS. For example, they may be particularly reluctant to have their footnote disclosures or other information filed with their tax returns, believing that this information may "red flag" potential tax issues.

paperwork and storage burdens

Further, the Service has been actively attempting to reduce (rather than increase) the paperwork and storage requirements involved in the filing of tax returns. (Note the Service's promotion and expansion of the electronic filing program and similar programs.) Requiring the filing of these financial statements and accompanying footnotes and other information may counteract the gains the Service has made thus far in reducing paperwork and storage requirement burdens.

using the information

Moreover, the Service may not use the vast majority of the information provided. To effectively use the information provided, the Service would have to have manpower possessing a certain level of expertise sift through each set of financial statements with accompanying information to recognize any potential tax issues for examination, adjustment, or etc. (for example, unusual footnotes, liabilities, or cash transactions).

no tax income statement

There would be no tax income statement included in the return, only a book income statement. (Only total taxable income would be reflected on the return). Providing that the book income statement be, in effect, a substitute for the tax income statement has the drawback that only the separate book (not tax) income and deduction amounts would be reflected on the return;

each of the separate M-1 adjustments would not be added into the applicable line item of book income or book deduction to derive a detailed breakdown of total taxable income (i.e., the separate tax deductions and items of gross income comprising taxable income). Rather, only the total M-1s would be added to the total book income to derive the total taxable income.

need to prepare a tax income statement

The Service nonetheless may now need to compute a tax income statement (or at least certain components of a tax income statement) from the information provided (e.g., for purposes of determining which corporations it should audit, if the Service continues to employ the current DIF score approach). In addition, the taxpayer may have to continue to compute a tax income statement anyway (or at least certain items of that statement) to maintain its tax records, e.g., to account for tax limitations, and tax bases, etc.

need to prepare detailed schedules M-1

Because the focus would be on financial statement income and the reconciling M-1 adjustments, a taxpayer would have to complete a more detailed schedule M-1, increasing the taxpayer's burden. The schedule M-1 would have to reflect all differences between financial statement income and taxable income. This presentation and reconciliation would include such potentially significant adjustments as eliminating entire corporations in the case of corporations accounted for in a consolidated financial statement (e.g., where parents own a greater than 50% but less than 80% interest in subsidiaries, where corporations choose not to file a consolidated return for tax purposes, or where the group has foreign subsidiaries).

"ADEQUATE FINANCIAL STATEMENT"

If the Service has the authority to require the filing of the taxpayer's financial statements and the Service requires the filing of the financial statements (referred to as "adequate financial statements" in the proposal), we do not object to basing the definition of an "adequate financial statement" on the former section 56(f) of the Code definition. However, for clarification purposes, we note that former section 56(f) is not a current Code section; it has been repealed.

In addition, the task group may be assuming that the majority of taxpayers have GAAP financial statements. However, we believe that most clients of small accounting firms do not have their financial statements audited, and may not use GAAP. These corporations may often use tax accounting rules in preparing their financial statements. The proposal therefore may not apply to smaller corporations in the same manner as larger corporations.

ADDITIONAL COMMENT

If the Service has the authority to require the taxpayer to file its financial statements and accompanying other information and pursues this filing approach, there may be less opposition to the proposal if the taxpayer is not required to attach *all* of its financial statements and accompanying footnotes and other information. The Service could require that the taxpayer only attach its financial statement balance sheet and financial statement income statement, without attaching the accompanying footnotes or other information. This modified approach would reduce the additional paperwork and storage problems generated by the requirement that the taxpayer attach *all* of its financial statements and accompanying footnotes and reports. In addition, taxpayers may be less concerned about filing their financial statements with their tax returns, if they are not required to attach the accompanying footnotes and other information. The significant disadvantage of this modified approach is that the Service would have less of an opportunity to spot potential tax issues. (However, the Service only chooses a very small percentage of filers for examination. Moreover, the very large corporations are audited each year, and one would assume that the agents auditing these large corporations already procure this additional information during the course of the audit.)

INTRODUCTION

The initial charge from the BEE-12 Committee establishing this 1120 task force was daring and broad. The task force was directed to evaluate Form 1120 with the primary objective of reducing burden to the taxpayer. Our first task was to determine whether or not the form was needed! Once we determined that the form was indeed needed, the next objective was to design a new Form 1120 which reduces taxpayer burden and also meets the needs of the Internal Revenue Service.

The task force approached this assignment from several different directions. One approach started with a blank sheet of paper. Form 1120 was designed by considering the natural flow of accounting information and taxpayers' record keeping processes which capture the data. Taxable income would be computed by using the data and reports normally generated by the accounting system. Taxpayers' financial statements would be the starting point for the determination of taxable income.

SUMMARY OF PROPOSAL

The starting point for the computation of taxable income is net income per financial statements. The net income per financial statements would be reconciled to taxable income on the face of the return by modifying the current Schedule M-1, Reconciliation of Income per Books with Income Per Return. The taxpayer's financial statements would become an integral part of the tax return and would be attached **in their entirety.** Schedule M-2, Analysis of Unappropriated Retained Earnings per Books, would be eliminated. Schedule J, Tax Computation, would remain the same and the questions on former page 3 would be identical to those recommended by this task force and discussed in Section 2 of this report. Schedule C would be a separate attachment also in keeping with the other proposal. Suggested forms would be available in the instruction booklet.

OVERVIEW OF THE FLOW OF ACCOUNTING INFORMATION

(The numbers correspond to the flow chart found on page 5-3)

1. Identify economic transactions and measure them in financial terms.

2. Record the measurements - the transactions are entered in monetary terms in journals and subsidiary ledgers according to GAAP (generally accepted accounting principles).

3. Classify accounting information - prepare trial balance(s) from the general ledger.

4. Report on the business activity - at this point the system for financial accounting purposes (F) and tax accounting purposes (T) diverges. The extent to which the financial and tax accounting systems differ is directly related to the size and complexity of the business entity.

FOR TAX REPORTING

5(T). Select trial balance(s) for inclusion in Form 1120. [1]

6(T). Make eliminations to arrive at separate taxable income for each includible corporation. [2]

7(T). Combine the separate taxable income of includible corporations. [3]

8(T). Make consolidated eliminations and computations to arrive at consolidated taxable income.

9(T). Prepare Form 1120.

FOR FINANCIAL REPORTING

5(F). Assemble the consolidated data and prepare the consolidating adjusting and eliminating entries.

6(F). Prepare financial statements according to GAAP. [4]

- - - - - - - - - - -

1 The starting point in the computation of consolidated taxable income is the taxable income or net operating loss of each member computed as though separate returns were filed. Reg. 1.1502-11.

2 The computation requires the elimination of profits and losses from transactions between members of the affiliated group and of dividend distributions within the group and the segregation of other transactions.

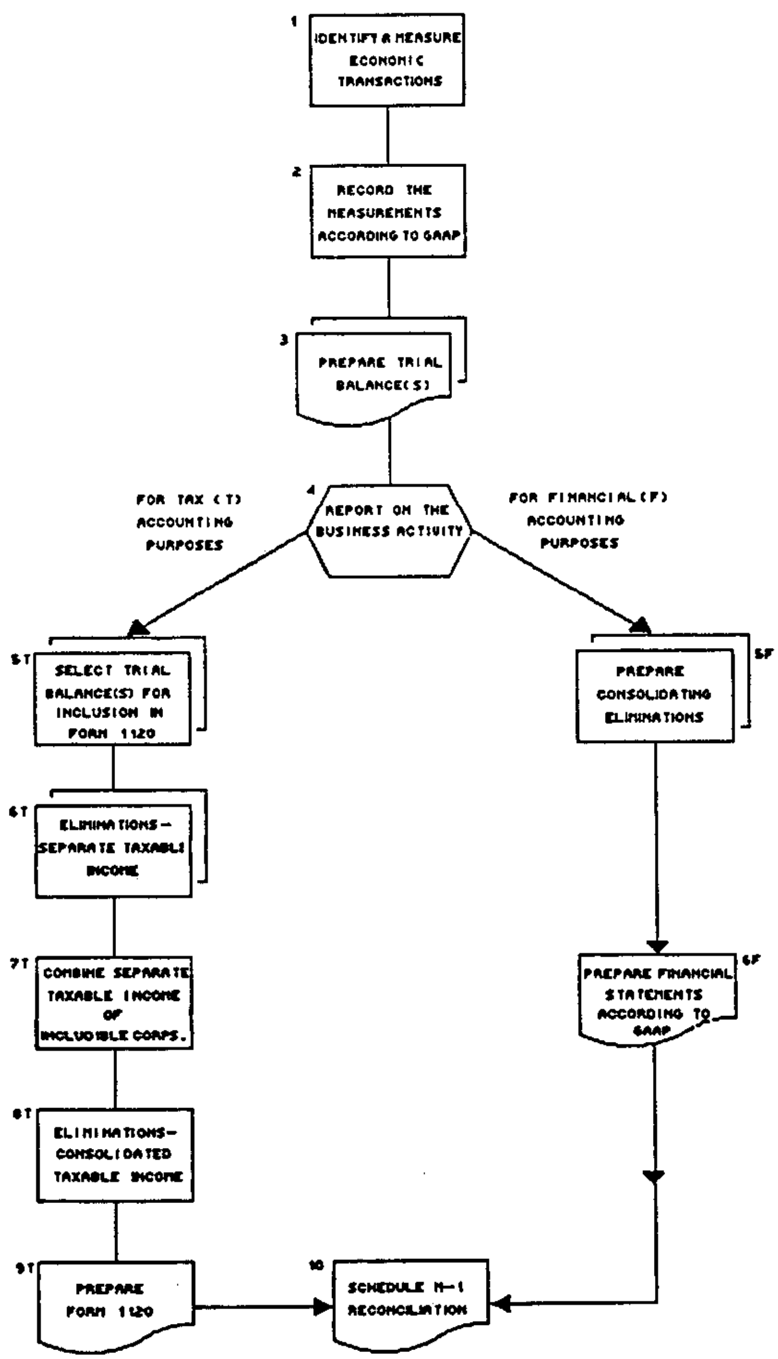
3 See T.R. 1.1502-75(j) for the requirements of the statements and schedules for subsidiaries.

4 The great majority of companies publish consolidated reports which include in the balance sheet and income statements the results and financial position of their subsidiaries. Different requirements exist for consolidation of subsidiaries for financial reports and for determination of consolidated taxable income. The most obvious are the percentage of ownership requirements, treatment of foreign subsidiaries, and exclusion of certain nonhomogeneous subsidiaries.

THE LINK BETWEEN THE TAX RETURN AND THE FINANCIAL REPORT

10. Reconcile net income per books with the taxable income per return - SCHEDULE M-1 is the theoretical link between the financial statements and the tax return.

Overview of the Flow of Accounting Information



SPECIFICS

1. Our recommended form, which requires the reconciliation of financial statement income to taxable income, follows this discussion. Examples of completed forms are in Appendices N & O.

2. The computation of taxable income will require that taxpayers reconcile the net income per the financial statements to taxable income as determined under the IRC of 1986.

   A. The financial statements are required to be attached to the revised Form 1120. This will necessitate a new definition of what constitutes "applicable financial statements." (See pages 5-9 through 5-12 for a discussion of the existing Code section relating to "applicable financial statements" and the new requirements mandated by this proposal.)

   B. The attached financial statements must be the same financial statements prepared for the Securities & Exchange Commission, shareholders, creditors or other users of financial information. They must be complete, including but not limited to the following: beginning and ending balance sheet, income statement, funds flow statement, statement of retained earnings or owner's equity, notes to the financial statements, any discussions of management, and the auditor's opinion.

3. The reconciliation of net income per financial statements to taxable income will require that taxpayers itemize the reconciling items attaching additional schedules as necessary.

4. The current law with respect to corporations and consolidated entities will continue to apply. However, minor changes may be needed with regard to the definition of "applicable financial statements" found in IRC section 56 and the requirement in the consolidated regulations that the separate entities be presented in columnar form, T.R. 1.1502-75(j). Additionally, there may be other required legislative changes which have not been identified to date.

ADVANTAGES

1. The use of financial statement information with a reconciliation to taxable income will negate the necessity of reclassifying financial data to fit existing lines on Form 1120. This will result in flexibility of presentation, thereby significantly reducing taxpayer preparation time and the associated costs. The task force computed taxpayer burden reduction to be approximately 192 million hours. (See Appendix D for the computation of taxpayer burden reduction expressed in terms of hours.)

2. Schedules and analysis previously prepared by the taxpayer would be readily available to support the data and in many cases would have been reviewed by independent auditors.

3. There will be a natural audit trail from the tax return to the taxpayer's books and records. This will reduce the taxpayer's examination burden and should also shorten the time span of any audit by Internal Revenue Service. This proposal has the support of the Tax Executive Institute. (See Appendix J for a reprint of the Discussion Draft on Form 1120 Submitted to IRS, dated February 8, 1980.)

4. Compliance will be enhanced, particularly for the larger taxpayers.

A. Currently, schedule M-1 is a primary audit tool for field examiners. Often book income is a derived amount which is not reconciled to financial statement income. The new schedule which reconciles net income per financial statements to taxable income will highlight all differences between book and tax income - both domestic and foreign. (Refer to Appendix R for actual examples from the Philadelphia District).

B. Schedule M-1 is used to classify corporate returns. The current schedule does not reveal so called "off-book" adjustments by top management or the outside auditors.

5. There will be fewer lines for the Service Center to input, thereby, reducing cost and transcription errors. This task force computed that the approximate cost savings would be in excess of $6.6 million. (See Appendix D for the computation of IRS Service Center cost savings.)

6. The concepts are universally applicable to all taxpayers.

7. Returns (particularly large taxpayer returns) may be filed earlier. Currently, the great majority of Coordinated Examination Branch taxpayers (assets > $250 million) request extensions of time for filing. The annual report filed by most publicly held corporations with the Securities and Exchange Commission, is due within 90 days following the close of the company's fiscal year. The annual report is the cornerstone of the financial statement approach. The 90 day due date for the annual report coupled with the reduction in burden of reclassifying and reorganizing data may enable the taxpayer to complete the return in a more timely fashion.

8. The financial statement approach is consistent with the approach used by other countries - most notably Canada. (See Appendix K for example of a Canadian return).

9. This financial statement approach is consistent with the principles of Compliance 2000. It will make it easier for taxpayers to comply with the provisions of the Internal Revenue Code and will reduce taxpayer burden.

10. Fragmented U.S. subsidiaries of common foreign parents are difficult to associate and identify. This is an area which lends itself to noncompliance. If financial statements were required, the possibility that we could identify these entities during classification would increase.

11. The Service would be able to identify additional joint ventures with foreign taxpayers on the new schedule reconciling net income per financial statements to taxable income.

DISADVANTAGES

1. Organizational resistance to change, particularly in relation to:

   A. Classification of returns by DIF. (Note: the task force does not consider this fatal. See Appendix I for a discussion of the usefulness of DIF in selecting 1120s for classification.)

   B. Collection of data by the SOI Division. (See Appendix H for alternative recommendations.)

2. Minor legislative or regulatory changes in the consolidated return regulations and a new definition of "applicable financial statements" are required. (See Appendix Q.)

Department of Treasury | For calendar year 1991 or tax year beginning.........,1991 ending......., 19.. | 1991
Internal Revenue Service

A Check if a -

1 Consolidated return []
2 Personal holding co []
3 Personal service co []

B Business code (Refer to list in instructions)

Name

Address

Address

City or town, state, and ZIP code

C Employer Identitication number

D Date incorporated

E Total assets (see Specific Instructions)

$

F Check applicable boxes: (1) [] Initial return (2) [] Final return (3) [] Change in address

Part I - Reconciliation of Net Income per Financial Statements to Taxable Income (Omit cents)

NOTE: Itemize all entries, attach separate schedules where more than one line item is combined

1 Net income per financial statements (attach copy of complete financial statements). . .
2 Losses from foreign entities . . . .
a DISC, FISC . . . . $
b Other foreign subsidiaries $
c Other
3 Losses from domestic entities not included on this return . . . .
4 Federal income tax . . . .
5 Excess of capital losses over capital gains
6 Other income subject to tax not recorded on the financial statements this year . . . .
7 Other expenses recorded on the financial statements this year not deducted on this return . . . .
a Depreciation . . . . $
b Contributions carryover. . . $
c Travel and entertainment . . $
8 Other increases
9 Total of lines 1 through 8

10 Income from foreign entities . . . . . .
a DISC, FISC . . . . $
b Other foreign subsidiaries $
c Other
11 Income from domestic entities not included on this return . . . .
12 Other income recorded on the financial statements this year not included on this return . . . .
a Tax-exempt interest . . . .$
13 Deductions on this return not charged against financial statement income this year . . . .
a Depreciation . . . . $
b Contributions carryover. . $
14 Other decreases
a
b
c
15 Total of Lines 10 through 14

16 Taxable income before net operating loss deduction and special deductions (line 9 less line 15) . . | 16

Note: If line 16 is an NOL, and you elect to forego carryback to the three preceding years, check here []

17 Less: a Net operating loss deduction (see instructions) . . . . | 17a

b Special deductions (Schedule C, line 20) . . . . | 17b

c Add Lines 17a and 17b . . . . | 17c

18 Taxable Income -line 16 less line 17c (See instructions for required attachments) . . . . | 18

Please Sign Here

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

▶ Signature of officer | Date | ▶ Title

Paid Preparer's Use Only

Preparer's Signature ▶ | Date | Check if self-employed ▶ [] | Preparer's social security number

Firm's name (or your's if self-employed) and address ▶ | E.I. No. ▶ | ZIP code ▶

1 Check if you are a member of a controlled group (see sections 1561 and 1563) . . . . . . ► []

2 If the box on line 1 is checked

a Enter your share of the $50,000 and $25,000 taxable income bracket amounts (in that order)

(i) $______ (ii) $______

b Enter your share of the additional 5% tax (not to exceed $11,750) ► $______

3 Income tax (see instructions to figure the tax). Check this box if the corporation is a qualified personal service corporation (see instructions). ► [] . . . . 3 ______

4a Foreign tax credit (attach Form 1118) . . . . 4a ______

b Possessions tax credit (attach Form 5735) . . . . 4b ______

c Orphan drug credit (attach Form 6765) . . . . 4c ______

d Credit for fuel produced from a nonconventional source (see instructions) . 4d ______

e General business credit. Enter here and check which forms are attached: . .

[] Form 3800 [] Form 3468 [] Form 5884 . . . .

[] Form 6478 [] Form 6765 [] Form 8586 . . . . 4e ______

f Credit for prior year minimum tax (attach Form 8801) . . . . 4f ______

5 Total - Add lines 4a through 4f . . . . 5 ______

6 Line 3 less line 5 . . . . 6 ______

7 Personal holding company tax (attach Schedule PH (Form 1120)) . . . . 7 ______

8 Recapture taxes. Check if from: [] Form 4255 [] Form 8611 . . . . 8 ______

9a Alternative minimum tax (attach Form 4626) . . . . 9a ______

b Environmental tax (attach Form 4626) . . . . 9b ______

10 Total tax--Add lines 6 through 9b. . . . . 10 ______

11 Payments:

a 1990 overpayment credited to 1991 . . . . 11a ______

b 1991 estimated tax payments . . . . 11b ______

c Less 1991 refund applied for on Form 4466 . . . . . 11c (______). d Bal ► 11d ______

e Tax deposited with Form 7004 . . . . 11e ______

f Credit from regulated investment companies (attach Form 2439) . . . . 11f ______

g Credit for Federal tax on fuels (attach Form 4136) . . . . 11g ______

h Total payments -- Add lines 11d through 11g . . . . 11h ______

12 Enter any penalty for underpayment of estimated tax - Check> [] if Form 2220 is attached . . . . . 12 ______

13 **Tax due** - If the total of lines 10 and 12 is larger than line 11h, enter amount owed . . . . 13 ______

14 **Overpayment** - If line 11h is larger than the total of lines 10 and 12, enter amount overpaid . . . 14 ______

15 Enter amount of line 14 you want: Credited to 1992 estimated tax ► Refunded ► . . 15

Additional Information Required (continued from page 1) — Yes | No

G Check method of accounting:
(1) [] Cash
(2) [] Accrual
(3) [] Other (specify) ► ______

H (1) Did the corporation at the end of the tax year own, directly or indirectly, 50% or more of the voting stock of a dom corp? (For rules of attribution see Sec 267(c)) If "Yes," attach a sched showing: (a) name, address, and identifying number; (b) percentage owned; and (c) taxable income or (loss) before NOL and special deductions of such corporation for the tax year ending with or within your tax year.

(2) Did any individual, partnership, corporation, estate, or trust at the end of the tax year own, directly or indirectly, 50% or more of the corporation's voting stock? (For rules of attribution, see section 267(c).). If "Yes," complete (a) through (c) . . . .
(a) Attach a schedule showing name, address, and identifying number
(b) Enter percentage owned ► ______
(c) Was the owner of such voting stock a person other than a U.S. person? (See instructions.) Note: If "Yes" the corporation may have to file Form 5472. If "Yes," enter owner's country ► ______

I Was the corporation a U.S. shareholder of any controlled foreign corporation? (See sections 951 and 957.) . . . . If "Yes," attach Form 5471 for each such corporation.

Additional Information Required (continued) — Yes | No

J At any time during the tax year, did the corporation have an interest in or a signature or other authority over a financial account in a foreign country (such as a bank account, securities account, or other financial account)? . . . . . (See inst F and filing req for form TD F 90-22.1) If "Yes" enter name of foreign country ► ______

K Was the corporation the grantor of, or transferor to, a foreign trust that existed during the current tax year, whether or not the corporation has any beneficial interest in it? . . . . If "Yes" the corporation may have to file Forms 3520, 3520-A or 926.

L During this tax year, did the corporation pay dividends (other than stock dividends and distributions in exchange for stock) in excess of the corporation's current and accumulated earnings and profits? (See sect 301 and 316) . . If "Yes," file Form 5452. If a consolidated return, answer here for parent corporation and on Form 851, Affiliations Schedule, for each sub.

M Check this box if corp issued publicly offered debt instruments with original issue discount [] If so, the corporation may have to file Form 8281

N Enter the amount of tax-exempt interest received or accrued during the tax year ► $______

The "financial statement approach" raises the question of what would constitute an adequate financial statement for purposes of filing a tax return, and ultimately reconciling net income per financial statement to taxable income. The Internal Revenue Code of 1986 provides a definition of financial statements in IRC section 56(f)(3)(A) (See page 5-12 for the current Code section). This definition concerns the computation of the book income adjustment for purposes of alternative minimum tax (AMT). The starting point in computing the AMT adjustment is the net income or loss reported on the taxpayer's "applicable financial statement." This Code section is only concerned with the income statement. However, it offers insight into what financial statements are considered "applicable" and provides a hierarchy if the taxpayer has more than one financial statement.

This task force developed more stringent requirements regarding what would constitute "applicable financial statements" for purposes of the "financial statement approach" to determine taxable income. Additionally, the task force concluded that the taxpayer's financial statements must be submitted in their entirety, including: balance sheet, income statement, statement of retained earnings, statement of cash flows, notes to the financial statement, auditor's opinion and management letter if applicable.

The task force wanted to insure that compliance with the provisions of the Internal Revenue Code was not diminished in the process of reducing the taxpayer's filing burden. A key to maintaining compliance is to require that the taxpayer use the same financial statement for income tax purposes as would be used for the Securities and Exchange Commission, shareholders, creditors, etc. The "applicable financial statement" would also be subject to hierarchical restrictions and would be required to be filed in its complete form including all disclosures, management letters, etc. The task force developed the following definition of what would be deemed to be adequate for purposes of the financial statement approach to determining taxable income.

DEFINITION

(A) In general the term "adequate financial statement" means, with respect to any taxable year, any statement covering such taxable year___

(i) For corporations subject to Securities and Exchange Commission Regulations--- the annual report to shareholders as required by the Commission. This must include all statements, disclosures (footnotes), management discussion, comparative analyses, supporting schedules, auditors opinion, etc. Any and all information submitted to the shareholders in the annual report shall be included without exception in order for the financial statements to be deemed "adequate".

(ii) For corpo[illegible]ions which have a certif[illegible] audit--- the Certified Financial Statements as prepared in their entirety. Refer to (i) above.

(iii) For corporations which have a review engagement governed by the Statements on Standards for Accounting and Review Services (SSARS) pronouncements No 1. through No 6.--- the financial statements prepared for the corporation in their entirety. Refer to (i) above.

(iv) For corporations not included in (i), (ii), or (iii) above, financial statements must include at a minimum but are not limited to the following:

INCOME STATEMENT

a. Operating Revenue
b. Cost of Goods Sold (Schedule A, "new COGS schedule" as envisioned by this task force)
c. Other Income broken down by category
d. Expenses - These are deductions which should be presented in the format of the taxpayer's natural expense categories including, if applicable, but not limited to the following:

1. Officers' Compensation
2. Contributions
3. Pension/Profit Sharing
4. Depreciation
5. Bad Debts
6. Other Deduction Itemized

BALANCE SHEET

a. The balance sheet must include both beginning and ending balances for the year. The format should utilize the taxpayer's natural asset, liability, and equity categories. These will include at a minimum but are not limited to the following:

ASSETS

1. Cash
2. Trade Notes and Accounts Receivable
3. Less Allowance for Bad Debts
4. Inventories
5. Other Current Assets (Itemize on attached schedule)
6. Loans to Stockholders
7. Other Investments (Itemize on attached schedule)
8. Building and Other Depreciable Assets
9. Accumulated Depreciation
10. Depletable Assets
11. Accumulated Depletion
12. Land (net of any amortization)
13. Intangible Assets (Amortizable only)
14. Other Assets (Itemize on attached schedule)
15. Total Assets

LIABILITIES

1. Accounts Payable
2. Other Current Liabilities (Itemize on attached schedule)
3. Loans from Stockholders
4. Other Liabilities (Itemize on attached schedule)

OWNER'S EQUITY

1. Capital Stock - Preferred
2. Capital Stock - Common
3. Paid-in or Capital Surplus
4. Retained Earnings - Appropriated (Itemize on attached schedule)
5. Retained Earnings - Unappropriated
6. Treasury Stock

(v) Special Rule Where More Than 1 Statement.---For purposes of subparagraph (A), if a taxpayer has a statement described in more than one clause or subclause, the term adequate financial statement shall refer to the statement described in the clause or subclause with the lowest number designation.

The starting point in computing the book income adjustment for purposes of Alternative Minimum Taxable Income (AMT) is the net income or loss reported on the taxpayer's "applicable financial statement." This term is defined in the Internal Revenue Code of 1986 by IRC section 56(f)(3)(A) as follows:

(A) IN GENERAL.--The term "applicable financial statement" means, with respect to any taxable year, any statement covering such taxable year--

- (i) which is required to be filed with the Securities and Exchange Commission,
- (ii) which is a certified audited income statement to be used for the purposes of a statement or report--
  - (I) for credit purposes,
  - (II) to shareholders, or
  - (III) for any other substantial nontax purpose,
- (iii) which is an income statement required to be provided to--
  - (I) the Federal Government or any agency thereof,
  - (II) a State government or any agency thereof, or
  - (III) a political subdivision of a State or any agency thereof, or
- (iv) which is an income statement to be used for the purposes of a statement or report--
  - (I) for credit purposes,
  - (II) to shareholders, or
  - (III) for any other substantial nontax purpose.

(B) EARNINGS AND PROFITS USED IN CERTAIN CASES.--IF--

- (i) a taxpayer has not applicable financial statement, or
- (ii) a taxpayer has only a statement described in subparagraph (A)(iv) and the taxpayer elects the application of this subparagraph,

the net income or loss set forth on the taxpayer's applicable financial statement shall, for purposes of paragraph (3)(A), be treated as being equal to the taxpayer's earnings and profits for the taxable year (without diminution by reason of distributions during the tax year). Such election, once made, shall remain in effect for any taxable year for which the taxpayer is described in this subparagraph unless revoked with the consent of the Secretary.

(C) SPECIAL RULE WHERE MORE THAN 1 STATEMENT.- For purposes of subparagraph (A), if a taxpayer has a statement described in more than 1 clause or subclause, the applicable financial statement shall be the statement described in the clause or subclause with the lowest number designation.

(D) EXCEPTION FOR CERTAIN CORPORATIONS.--This subsection shall not apply to any S corporation, regulated investment company, real estate investment trust, or REMIC.